REPORT OF EXAMINATION
OF THE

CAMICO MUTUAL INSURANCE COMPANY

AS OF
DECEMBER 31, 2003

Participating State
and Zone:

California, Zone IV - Western

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San Francisco, California
February 4, 2005

Honorable Alfred W. Gross
Chairman, NAIC Financial Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Morrison
Secretary, Zone IV – Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

CAMICO MUTUAL INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office, 1235 Radio Road, Redwood City, California 94065.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2000. This examination covers the period from January 1, 2001 through December 31, 2003. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination.

In addition to those items specifically commented upon in this report, other phases of the Company’s operations were reviewed including the following areas that require no further comment in this report: corporate records; fidelity bonds and other insurance; officers, employees and agents welfare and pension plans; growth of company; business in force by states; and sales and advertising.

SUBSEQUENT EVENTS

In early 2004, the Company obtained a $5 million revolving line of credit from Wells Fargo Bank (WFB). To secure the line of credit, the Company pledged $5.6 million (par value) in Federal Home Loan Mortgage Corporation securities to WFB. These securities are currently held in a separate custodian account with the BNY Western Trust Company. Company management indicated that the line of credit was obtained to allow the Company flexibility in investing operating cash that previously was invested in low yielding money market accounts.

During the latter part of 2004, subsequent to the date of this examination, the Company submitted an application to the California Department of Insurance (CDI) for approval of a $10 million surplus note that will be issued by the Company to FTN Financial Capital Markets, a division of the First Tennessee Bank National Association. Company management indicated that funds from the note would be used to support premium growth, strengthen the Company’s balance sheet, and allow the Company to modify its reinsurance program, including the acceptance of a higher reinsurance retention level in its first reinsurance layer. As of the date of this report, the application is under review by the CDI.

COMPANY HISTORY

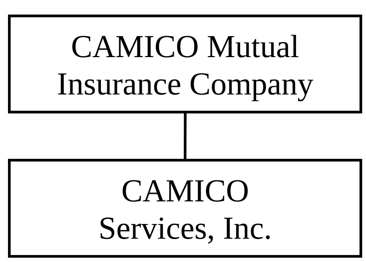
The Company was incorporated under the laws of California on March 4, 1986, as Cal Accountants Mutual Insurance Company, and commenced operations on June 30, 1986. The Company adopted its present name of CAMICO Mutual Insurance Company on September 29, 1995.

The Company was initially capitalized through the issuance of certificates of contribution to all new policyholders. This practice was discontinued in July 1991. After accumulating sufficient unassigned surplus, the Company starting in 1994 began to redeem the certificates of contribution and pay-off the accumulated interest on the certificates. All outstanding certificates were redeemed and retired by year-end 1998.

In December 1999, the Company entered into an agreement with Design Professional Insurance Company, Security Insurance Company of Hartford, and the Connecticut Indemnity Company (DPIC Companies) to manage and assume a book of accountant's professional liability that was previously underwritten by the DPIC Companies. This agreement enabled the Company to expand its insurance program nationwide.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system, which includes a wholly-owned subsidiary, CAMICO Services, Inc. (CSI). CSI is a licensed agent and operates primarily as an agent intermediary offering certain insurance coverages underwritten by other insurance carriers to the Company's policyholders. The following organizational chart depicts the relationship of the companies within the holding company system:



The board of directors is vested with the authority to manage the Company. A listing of the members of the board and principal officers serving as of December 31, 2003 follows:

Board of Directors

Name and Residence	Principal Business Affiliation
Kenneth J. Ashcraft Brentwood, California	Retired CPA
Louis J. Barbich Bakersfield, California*	Managing General Partner Barbich, Longcrier, Hooper & King
Robert E. Carne San Diego, California*	CPA and Partner McKay, Carne, Buniva & Lazarus, LLP
Robert C. Daney San Jose, California*	CPA and Partner Brach, Neal, Daney & Spence, LLP
John A. Dodsworth Los Altos, California	President and Chief Executive Officer CAMICO Mutual Insurance Company
Robert P. Evans Fort Worth, Texas*	CPA and Partner Sproles, Woodard, LLP
Victor I. McCarty Long Beach, California	Retired CPA
John W. Meara Kansas City, Missouri*	CPA and Partner Meara, King & Co., a Professional Corporation
Robert G. Nuber Bellevue, Washington*	CPA and Chairman Clark Nuber, Professional Services
Diana P. Sanderson** Walnut Creek, California*	CPA and Owner Diana P. Sanderson & Associates
Stuart M. Weinstein San Francisco, California*	CPA and Partner RINA Accountancy Corporation

* denotes business address
** name changed to Diana P. Sanderson-Mori in 2004 due to marriage

Principal Officers

Name	Title
John A. Dodsworth	President and Chief Executive Officer
Stuart E. Olson	Vice President, Treasurer and Chief Financial Officer
Ronald B. Klein	Vice President and Secretary
Sandra A. Maker	Vice President
Ricardo R. Rosario	Vice President
Gail A. Dennis	Vice President

Inter-Company Agreements

Cost Allocation and Reimbursement Agreement: The Company has a Cost Allocation and Reimbursement Agreement with its subsidiary, CAMICO Services Inc. (CSI), whereby the Company performs certain functions and provides certain services to CSI. The services include, but are not limited to, general corporate management, investment advice, strategic planning, product development, computer services, advertising, and marketing. Under the terms of the agreement, the Company is reimbursed on a cost allocation-reimbursement basis.

Tax Allocation Agreement: The Company is a party to a tax allocation agreement with its subsidiary, CSI. The agreement provides for the federal tax returns of the parties to be filed on a consolidated basis. Allocation is based on separate company return calculations with fair compensation to the parties for use of net operating losses, alternative minimum tax, or tax credits that are used to reduce the consolidated federal income tax liability of the group.

TERRITORY AND PLAN OF OPERATION

The Company provides professional liability insurance on a claims-made basis to certified public accounting firms. It specializes in providing coverage for small to medium-sized certified public accounting practices with limited or no Securities and Exchange Commission engagements, initial public offerings or large company audit work. The Company also provides extended reporting endorsement (ERE) coverage for policyholders who die, become disabled or retire. The Company provides the ERE coverage at no cost to all sole proprietors with a minimum of five years of continuous coverage with the Company.

As of December 31, 2003, the Company was licensed to transact insurance in the District of Columbia and all states except Alaska, Hawaii, Montana, North Dakota, Rhode Island, Vermont, and Wyoming. In 2003, the Company wrote $45,226,873 in direct premiums ($29,540,701 on a net basis) with business written by the five highest producing states as follow: California - $24.6 million (54.4%), New York - $1.8 million (3.9%), Maryland - $1.5 million (3.3%), Pennsylvania - $1.4 million (3.0%), and Georgia - $1.4 million (3.0%).

Approximately 63% of the direct written business in 2003 was produced directly by the Company's in-house marketing staff. The remainder of the business was produced by 55 independent agents.

REINSURANCE

Assumed

During the period of this examination, the Company assumed a fronted book of business that was written in states in which it was not yet licensed. This book of business was written directly by Fairfield Insurance Company, reinsured by General Reinsurance Corporation, which then retroceded the book to the Company. This fronting arrangement was terminated on December 31, 2003 as the Company became licensed in the states where the fronted business was written. Currently all business is written directly.

Ceded

During the period of this examination, the Company's per occurrence retention has been $750,000. The following exhibit summarizes the major reinsurance agreements in force at December 31, 2003:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
Casualty Excess of Loss	Folksamerica Reinsurance Company (20%) Hannover Ruckversicherungs-Aktiengesellschaft (20%) Partner Reinsurance Company of U.S. (20%) Aspen Insurance UK Ltd. (16.25%) Lloyd's Underwriters (23.75%)	$750,000 per claim per policy; and 10% loss in excess of policy limit & extra contractual obligations	$2,250,000 per claim per policy, subject to a limit of 300% of net ceded premium during the term of contract
Automatic Facultative Casualty Excess of Loss	Aspen Insurance UK Ltd. (28.58%) Lloyd's Underwriters (71.42%)	$3 million per claim per policy; and 10% loss in excess of policy limit & extra contractual obligations	$2 million per claim per policy
Certificates of Casualty Facultative Reinsurance	General Reinsurance Corporation (100%)	$5 million per claim; $10 million policy aggregate	$5 million per claim; $10 million policy aggregate
Casualty Contingency Excess of Loss (1st & 2nd Event)	Aspen Insurance UK Ltd. (18.18%) Lloyd's Underwriters (81.82%) (Coverage as respects loss in excess of policy limit & extra contractual obligations applies to all policies)	The greater of $3 million per claim per policy; or the policy limit, and 10% loss in excess of policy limit & extra contractual obligations	$4 million per claim per policy $4 million per occurrence $8 million all occurrences during term of the agreement, including one reinstatement
Casualty Contingency 3rd & 4th Event Coverage Excess of Loss	Lloyd's Underwriters 50% Self Insured *50% (Coverage as respects loss in excess of policy limit & extra contractual obligations applies to all policies)	The greater of $3 million per claim per policy; or the policy limit, and 10% loss in excess of policy limit & extra contractual obligations *(This contract has only 50% reinsurers' participation. The remaining 50% was not placed with any reinsurer)	$4 million per claim per policy $4 million per occurrence $8 million all occurrences during term of the agreement, including one reinstatement (This coverage shall not apply until the 1st & 2nd occurrences aggregate loss of $8 million has been exhausted)

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
Casualty Clash & Stop Loss	General Reinsurance Corporation (100%)	Part A: Retention equal to 74% of Net Subject Premium Earned (net of all reinsurance premiums) Part B: $750,000 ultimate net loss per occurrence involving more than one policy	$3 million (Parts A & B combined) in the aggregate as respects occurrences and claims made, during the term of the agreement

All of the Company's reinsurers were authorized carriers.

ACCOUNTS AND RECORDS

In reviewing matters (reported potential claim incidences) that were converted to claims during the first part of 2004 to test the completeness of the Company's 2003 unpaid claims inventory, it was noted from the sample taken that there were five instances in which matters were not converted to claims on a timely basis. Based on the claim adjuster's notes and evidence in the claim file, there was clear liability and the five matters should have been converted to claims prior to year-end 2003. This situation could result in the skewing of actuarial factors used in the projection of losses, which in turn could affect the accuracy of the actuarial projections of the Company's ultimate losses. It is recommended that the Company review its claims procedures to ensure that claims are opened on a timely basis and that reported losses are recognized in the proper reporting period.

<u>FINANCIAL STATEMENTS</u>

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Reconciliation of Surplus as Regards Policyholders from December 31, 2000 through December 31, 2003

Statement of Financial Condition
as of December 31, 2003

Assets	Ledger and Non-ledger Assets	Nonadmitted Assets	Net Admitted Assets	Notes
Bonds	$ 81,499,533	$	$ 81,499,533	
Common stocks	6,758,242		6,758,242	
Cash and short-term investments	3,643,828		3,643,828	
Investment income due and accrued	1,201,068		1,201,068	
Uncollected premiums, agents' balances in course of collection	3,207,552	275,246	2,932,306	
Amounts recoverable from reinsurers	370,236		370,236	
Net deferred tax asset	3,108,778	938,487	2,170,291	
Electronic data processing equipment and software	438,650	261,553	177,097	
Furniture and equipment	268,678	268,678		
Receivable form parent, subsidiaries and affiliates	2,881		2,881	
Other assets nonadmitted	239,606	239,606		
Aggregate write-ins for other than invested assets	996,018	769,7201	226,298	
Total assets	$101,735,070	$ 2,753,291	$ 98,981,780	

Liabilities, Surplus and Other Funds				
Losses			$ 25,709,256	(1)
Loss adjustment expenses			16,311,761	(1)
Commissions payable, contingent commissions and similar charges			430,060	
Other expenses			4,423,581	
Taxes, licenses and fees			404,138	
Federal income taxes			621,755	
Unearned premiums			9,090,144	(2)
Advance premiums			5,540,101	
Ceded reinsurance premiums payable			3,637,440	
Amounts withheld by company for account of others			99,388	
Remittances and items not allocated			21,129	
Payable for securities			561,125	
Aggregate write-ins for liabilities			180,896	
Total liabilities			67,030,774	
Unassigned funds (surplus)		$ 31,951,006		
Surplus as regards policyholders			31,951,006	
Total liabilities, surplus and other funds			$ 98,981,780	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2003

Statement of Income

Underwriting Income		
Premiums earned		$ 27,303,443
Deductions:		
Losses incurred	$13,076,669	
Loss expenses incurred	6,458,256	
Other underwriting expenses incurred	10,513,318	
Aggregate write-ins for underwriting deductions	10,004	
Total underwriting deductions		30,058,247
Net underwriting loss		(2,754,804)
Investment Income		
Net investment income earned	$ 3,754,304	
Net realized capital gains	430,022	
Net investment gains		4,184,326
Net income before federal income taxes		1,429,522
Federal income taxes incurred		250,684
Net income		$ 1,178,838

Surplus Account

Surplus as regards policyholders, December 31, 2002		$ 29,211,716
Net income	$ 1,178,838	
Change in net unrealized capital gains	1,024,548	
Change in net deferred income tax	75,771	
Change in nonadmitted assets	(174,189)	
Change in provision for reinsurance	156,600	
Cumulative effect of changes in accounting principles	477,722	
Change in surplus as regards policyholders		2,739,290
Surplus as regards policyholders, December 31, 2003		$ 31,951,006

Reconciliation of Surplus as Regards Policyholders
from December 31, 2000 through December 31, 2003

	Gain in Surplus	Loss in Surplus	
Surplus regards as policyholders, December 31, 2000 per Examination			$ 26,073,541
Net income	$ 2,393,260	$	
Change in net unrealized capital gains	159,553		
Change in net deferred income tax	750,857		
Change in nonadmitted assets		52,267	
Change in provision for reinsurance	6,804		
Cumulative effect of changes in accounting principles	2,393,645		
Aggregate write-ins for gains in surplus	225,613		
Total gains and losses in surplus	$ 5,929,732	$ 52,267	
Increase in surplus			5,877,465
Surplus as regards policyholders, December 31, 2003 per Examination			$ 31,951,006

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The California Department of Insurance (CDI), pursuant to California Insurance Code (CIC) Section 733(g), retained a consulting actuary for the purpose of providing a full actuarial evaluation of the Company's loss and loss adjustment expense reserves as of December 31, 2003. The results of the evaluation indicated that the Company's loss and loss adjustment expense reserves were reasonably stated.

(2) Unearned Premiums

The CDI retained a consulting actuary to determine the reasonableness of the Company's extended reporting endorsement (ERE) policy reserve that is included in the Company's unearned premiums reserve. Based on the examination of the supporting data and assumptions, the CDI consulting actuary concluded that the Company's carried reserve of $2,191,000 at December 31, 2003 was deficient by $612,000. No adjustments were made to the Company's financial statements to reflect the deficiency, as it was not considered material to its balance sheet.

The primary reasons for the deficiency were: 1) the Company's consulting actuary did not factor in adjusting and other (unallocated) expenses into his calculations of the ERE policy reserve; 2) the discount rate used by the Company's consulting actuary is higher than the risk-free rate, which is the maximum discount rate allowed by the CDI in the calculation of the ERE policy reserve; and 3) the model used for calculating the ERE policy reserve is over five years old and needs to be updated and modified. It is recommended that the Company direct its consulting actuary to factor adjusting and other (unallocated) expenses into the calculation of ERE policy reserve. The Company should also direct its consulting actuary to use a discount rate no higher than the risk-free rate, as determined by the yield to maturity on a United States treasury debt instrument with maturity consistent with the average period of time between premium collection and loss payment under the ERE coverage. It is also recommended that the Company commission a new study to update its ERE policy reserving model to a current basis.

Also during the review of the Company's ERE policy reserve, it was noted that the Company was not consistently capturing the age of its policyholders. The age for sole proprietors is a factor in the calculation of the Company's ERE policy reserve. It is recommended that the Company capture the age of its current policyholders and that the Company modify its policy application to provide for the capturing of the applicant's birth date.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records (Page 8): It is recommended that the Company review its claim's procedures to ensure that claims are opened on a timely basis and that reported losses are recognized in the proper reporting period.

Comments on Financial Statement Items – Unearned Premiums (Page 13): It is recommended that the Company direct its consulting actuary to factor adjusting and other (unallocated) expenses into the calculation of the Company's extended reporting endorsement policy reserve.

Comments on Financial Statement Items – Unearned Premiums (Page 13): It is recommended that the Company direct its consulting actuary to use a discount rate no higher than the risk-free rate, as determined by the yield to maturity on a United States treasury debt instrument with maturity consistent with the average period of time between premium collection and loss payment under the ERE coverage.

Comments on Financial Statement Items – Unearned Premiums (Page 13): It is recommended that the Company commission a new study to update its extended reporting endorsement policy reserving model to a current basis.

Comments on Financial Statement Items – Unearned Premiums (Page 13): It is recommended that the Company capture the age of its current policyholders and that the Company modify its policy applications to provide for the capturing of the applicant's birth date.

Previous Report of Examination

Reinsurance – Ceded (Page 5): All of the Company's reinsurance agreements had insolvency clauses that did not fully comply with California Insurance Code (CIC) Section 922.2. Additionally, the offset clause in the Company's Casualty Aggregate Stop Loss was also not in compliance with CIC Section 1031 in that the accounts to be offset are not mutual debits and credits. The Company's reinsurance agreements are currently in compliance with the above CIC sections.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

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Howard S. Wong, CFE
Examiner-In-Charge
Department of Insurance
State of California